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ADDRESS

of

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before the

ECONOMIC CLUB OF CHICAGO

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PALMER HOUSE

Chicago, Illinois

April 29, 1936 - 6:30 P.M.

Two years ago I had the privilege of addressing this audience here in Chicago. At that time the Securities Exchange Act had just been passed. Misgivings abounded both as to its efficacy and its objectives, heightened undoubtedly by the intensity of feeling that the passage of that Act had aroused. I tried in that talk of two years ago to make plain some of the aims of both that Act and the Securities Act. Two years, it is true, is a very short time from any long range viewpoint; and it is clear today that the past two years represent only the beginnings of development in the technique of securities regulation. But I recall that two years ago the problems we faced seemed enormous and almost insurmountable.

It was shortly after I spoke to you that the new Securities and Exchange Commission was appointed. It is worth our while thinking back to the situation that it faced. The Securities Act had been in operation for a year, yet its obligations were shunned by finance and its objectives a matter of mystery and suspicion. The capital markets were temporarily stagnant and popularly spoken of as "frozen". Lawyers felt it their duty to warn clients against imagined dangers of accepting the obligations that Act imposed. It was generally alleged and popularly believed that the Act was not only unworkable, but that it completely impeded the flow of capital and was acting as a deterrent to recovery. I think the fears of business men with respect to the Securities Act were typified in a question which was asked me at this meeting of two years ago. The question was this: "If you were a director or an officer of a large corporation would you sign a registration statement, having in mind your wife and family?"

That perhaps illustrates something of the fears and of the problem the new Securities and Exchange Commission had to face. We had a few basic registration forms still in a very experimental stage; we had the framework of a set of rules and regulations, many of them untried and awaiting modification and amendment. But up to that time we had had neither the confidence nor the understanding of the business community.

The public attitude toward the new Exchange Act was very much the same. In going over some old papers the other day I happened across a package of cards on which were written those questions which were asked me at this last meeting. I have referred to one that seemed quite representative of public sentiment toward the Securities Act. Here are a few that dealt with the newly passed Exchange Act. One question asked, "Won't the stock exchange regulation act tend to drive money from the United States to other markets such as Toronto, London, etc?" Another question: "Is it the intention of the Securities Exchange Act to decrease trading in stocks on the stock exchanges? If so, why?" Another man expressed himself in this manner: "The volume of trading on the stock exchanges today is about 1/10 of the volume a year ago. In your opinion how much of this decrease is due to the Securities Act of 1933 and the stock exchange regulation act just passed?" There was the genuine worry of this question: "What effect will the stock exchange bill have on the delisting of securities?"

There were many others in a similar vein. I am sure you can easily remember how most of us felt at that time. I say most of "us" advisedly for, while the many problems presented by the Exchange Act were a source of

genuine worry to you, they were certainly as grave a source of worry to those who had the responsibility of making what was then merely a law into a living and active institution.

Some 45 securities exchanges had to be granted either registration or exemption in accordance with the terms of the new Act. Registration had to be provided for some 5,000 securities listed and traded on those exchanges. Requirements and forms had to be drafted to cover the variety of situations that they presented. Rules had to be drawn to implement almost every section of the Act, and each of these necessitated consideration of the sensitive and delicate mechanisms of finance. There were temporary registration and permanent registration, pools and proxies, annual reports and insider's reports, floor trading rules and over-the-counter rules, each a new problem requiring an untried technique.

It is fair to liken the work that has been done during these past two years to that of constructing a complex machine. But unlike the problem of the engineer or the draftsman, this machine, from its very nature, had to be kept running without breakdown through all the stages of its construction. A temporary framework was all that could be at first erected, for indeed the data for judgment were still in the main lacking. Defects naturally appeared, calling for quick substitution or repair. Fortunately a cooperative spirit was present, together with toleration for our mistakes.

Even now only the major outlines of the structure are apparent. As it stands today it is far from complete. The greatest part of our equipment for the work of protecting the investor has yet to be developed. The Securities and Exchange Commission today faces not the gentle task of polishing and refining, but the stern work of continued building. The very incompleteness of our work makes it mutually worth our while to consider where we are and whither we may be tending.

A great deal has been said about the technical aspects of the Securities Act and the Securities Exchange Act, but it is not my purpose here to detail the mechanics of these two statutes. Rather let me discuss with you the general objectives which these two complementary statutes prescribe for protecting the investors in our securities markets, and the extent to which these purposes have and can be realized:

Three major principles are to govern. The first is that of controlling the extent of credit available for the purpose of purchasing and carrying securities -- a control designed to prevent undue speculation in our security markets through the ready availability of credit for that purpose. The second aim -- and this is basic to the entire legislative scheme -- is the work-a-day task of making the investment problem less a matter of mystery and more a matter of intelligence, by seeking and presenting adequate information about companies whose securities are traded upon the national markets or are offered for sale upon a national scale. And, finally, this

legislation seeks to drive fraudulent and questionable practices from the securities business, penalizing deceit in the sale of securities and banning manipulative tactics from our stock exchanges.

To accomplish the first objective, that of curbing undue speculation through the excessive use of credit, the Federal Reserve Board (now the Board of Governors of the Federal Reserve System) was given the power to control both the extent to which securities could be carried on margin by brokers and also the extent to which banks and other financial institutions could lend to others for the purpose of purchasing or carrying equity securities. The method by which this system of margin control was introduced is illustrative of a major principle of all good administration, to introduce control with a minimum of friction and readjustment. In 1934, it was believed that the existing rates of margin required by the exchange rules and the customs of the trade were too low. On the other hand, it was recognized that a sudden increase in these rates might well have an effect of retarding for a period of time the thin but increasing flow of financing and the gradual improvement of security values that was then taking place. A solution to this apparent dilemma was evolved by the so-called three-pronged margin formula, one of whose purposes was to increase margins as security values enhanced until they should reach the ratio of 45 per cent of market value.

The effect of the application of these rules is interesting to follow. Prior to their promulgation, the exchanges' own margin requirements applicable to fair-sized accounts, stood at a little less than 24 per cent of the market value of the securities carried. The regulations that went into effect on October 1, 1934, had the general effect of increasing that ratio to about 28 per cent. As the result of the general enhancement in security values, without alteration of the regulations and by a process of gradual application, in January of this year the general level of these rates had climbed above 40 per cent of market value. This increase continued, so that when recently the Governors of the Federal Reserve System provided a flat ratio of 55 per cent of market values, no noticeably serious market-wise effect or serious objection was made to that change.

It is not my purpose here to discuss at length the work and responsibilities of another governmental agency, but I may, perhaps, be pardoned in referring to this experience as indicative of two factors: first, that of reaching objectives by a gradual but firm method of procedure; and, secondly, as demonstrative of a determination to prevent the direct use of credit from making possible undue speculative movements in our security markets.

More important, perhaps, from the long term viewpoint, is the second great objective of this legislation. This is the prosaic but penetrating effort to bring about adequate disclosure of the facts concerning securities of national importance. I need not take you through the mechanics whereby that disclosure is achieved. The past two years has witnessed financing operations in the neighborhood of four billion dollars through the channels of the Securities Act, and the registration of the vast majority of securities that are listed upon our national securities exchanges. The Commission has attempted to facilitate compliance with the registration requirements by devising forms for reporting that are appropriate for the divergent types of business that must use them. While the first steps for securing this disclosure have been taken and a skeleton framework set up, the task of moulding that framework to meet the varying demands upon it still remains to be done. No provisions yet exist, for example, for providing for current quarterly information from corporations listed upon exchanges that fall within the class for which such reports would be appropriate. The difficulty of providing adequate reporting forms to meet their special needs leaves some types of listed securities still exempt from the reporting requirements until further studies have been made. For new issues, a few basic reporting forms have been promulgated, but there is need for further refinement to make the required disclosure more suitable to the needs of the individual investor and the type of business that seeks new funds.

It is to the significance of this principle of disclosure that I wish to turn your attention. It rested upon two great faiths, the first of which is now a reality, and the second whose realization is incapable of being judged over such a short period of time. The first was the faith that American industrial enterprise would recognize the importance to itself of accepting the responsibilities of full and complete disclosure. How American enterprise measured up to that faith is, to me, a thing that bespeaks the true and abiding greatness of this country. The assumption of this responsibility and - considering the traditions of the past, it was not a light responsibility - was as a whole gladly undertaken. True, there were some grumblings as to the disclosure of some details, such as corporate salaries and data as to sales. Indeed, in some of the latter instances where the circumstances were extremely unusual, the Commission exercised its discretion to grant the plea for confidential treatment. In only a few instances have corporations differed so with the Commission's judgment on these matters that they are seeking to review it in the courts.

The importance of the assumption of this responsibility of disclosure lies in the fact that American business has voluntarily recognized the obligations of corporate management to its vast and scattered ownership. It implies greater fidelity to those fiduciary standards which must of necessity govern in the case of what can truly be called public corporations.

The assumption of these obligations carries with it also another and equally fundamental elevation of standards. These are the standards of independence and of professional excellence which experts, such as accountants or engineers, set for themselves. Any management that cannot face the analysis of independent experts is inherently to be distrusted. In its insistence upon the independence and integrity of these experts the statute bolsters forces that were at work within these professions even before its passage. And what the Commission can and does give is support to the accountant who has a true sense of his responsibility to the investing public in whose behalf he is employed. In securing independence and integrity for experts such as these, a far more vital protection is given the investor than what can be afforded by even the best watchdogging of a governmental body.

The second faith, the one that I said could only be gauged from the standpoint of realization years hence, is the faith that as security buyers we, as a nation, would become more intelligent and less likely to seek the shearing that the hope of speculative profits always holds. Recovering from 1929, we felt determined that this thing must not occur again. Some of the blame for that debacle we put where it rightly belonged -- on manipulative tactics, on irresponsible corporate management, on the malpractices of issuing houses, and the like. These things we sought to prevent, and effective legislation with efficient administration may well eliminate these abuses. But some of that blame, perhaps a large part, rested only upon us in our cupidity -- our desire to make something out of nothing or out of very little. That impulse, it is true, had some excuse where inadequate disclosures forced the substitution of blind guesses for reality. But the principle of disclosure can have the effect of narrowing the margin of guess-work, and make possible the line of demarcation between investment and speculation. In other words, the means for national self-discipline are at hand, but only time can tell whether they will be employed.

Every effort that is reasonably possible for the dissemination of investment information is being pursued by the Commission. Marked improvement is to be seen in the quality of annual reports to stockholders. Proxies are slowly becoming intelligible. The material in our reference rooms, in Washington, New York and Chicago is drawn upon daily by leading financial services and truly conscientious investment advisers.

In accomplishing our task of making available basic information to a purchaser of securities, whether old or new, only a portion of the field has been covered. True it is that no public offering of a security, with some minor exceptions, may now be made unless information is given. True it is also that no new securities may be listed upon an exchange without accompanying publicity of the necessary facts concerning its issuer. Yet there remains a vast reservoir of securities for which information is not required. These are securities already issued by companies, the management of which has not sought for them an exchange market, and which may not be adapted for daily trading to that type of market. But the desirability of extending this principle of disclosure to all securities of a national character was recognized in the beginning by Congress, for it directed the Commission to adopt rules and regulations to secure to investors trading in these over-the-counter markets protection comparable to that provided for investors who purchase securities upon national securities exchanges.

An exchange market is obviously a privilege and admission to this market could therefore be conditioned upon the disclosure of adequate information. If the management did not choose to assume this responsibility no irreparable loss would be suffered by security holders since the over-the-counter market remained. But this technique of exclusion from the market in the absence of adequate disclosure would clearly be too harsh, if used to compel the giving of information about securities whose only market is over-the-counter. The burden of such a penalty would fall heaviest upon the innocent security holder who would be deprived of practically all liquidity by having only an intrastate market in which to realize upon his holdings. In legislation now pending before Congress, the Commission sought to alleviate this situation by requiring corporations floating a security issue of a truly national size to file, in addition to the information required by the Securities Act of 1933, and in the absence of its assumption of responsibilities under the Exchange Act, periodic reports during the period that the security is outstanding in the hands of the public. No over night results will spring from this requirement. Only slowly, as new money is sought, or as new corporations are formed, will the end of adequate disclosure of the facts concerning securities in our over-the-counter markets be achieved.

We have had too little experience to tell whether the flow of new capital into industry is, as a result of the requirements for disclosure, reaching any new and less wasteful direction. We have had enough, however, to know that we can nip many a fraudulent scheme in the bud, and because of our watchfulness drive the gentry who conceive these schemes to other climates and other pursuits more healthful to their seemingly incurable temperaments. We have also had enough experience to know that disclosure is effective, and to gauge the building of heavy and healthful sales resistance as the inferior quality of a security offering becomes patent to those who will take the small time to read. This aspect of our work is, in truth, conservation of our financial resources, perhaps unspectacular but nevertheless very real.

The final objective of our securities legislation was to provide a federal agency to cope with fraudulent practices in the sale of securities that had achieved a nation-wide scale in size and theatre of operations. In addition to a general prohibition of fraud in the sale of securities, the Securities Exchange Act has specifically forbidden certain types of activities upon exchanges. These are the familiar tactics of the manipulator:- the wash sale and the matched order, the creation of actual or apparent trading activity solely for the purpose of attracting others into the market, and the familiar methods of rumor and tip. To accomplish these purposes the statutes have armed our Commission with two powers: - to transmit evidence of these activities to the Department of Justice for criminal prosecution, or to bring action upon our own initiative in the courts to enjoin persons from the continuance, actual or threatened, of such practices. And, under the Exchange Act, as an additional means of driving manipulative practices from the exchanges, by an administrative proceeding, subject to judicial review, the Commission may suspend or expel persons found guilty of such practices from the business of brokers or dealers as well as from the exchanges. In its effort to stamp out fraud and manipulation, the Commission has availed itself of all of these methods.

In a recent case the Commission obtained preliminary injunctions against 16 persons who were engaged in forcing up the price of a stock on an exchange for the purpose of unloading their own holdings on the public at a profit. The method they used was to subsidize a number of people in the securities business to recommend the stock to their clients in the guise of giving impartial advice. The public was so taken in that the price of the stock rose about 50% and trading volume increased six times, which would have enabled the manipulators to realize a tidy profit, had not the Commission intervened. In this transaction, the actual trading took place in a single city but the tipsters operated in at least a half a dozen cities in various parts of the country.

I cite this instance merely to illustrate the national character of many of these frauds and the necessity of controlling them, if they are to be controlled, by an agency which can disregard the limitations of state lines.

It is hardly appropriate for an enforcing agency to measure the success or failure of its achievements in the prevention of fraud or manipulation. Any casual observer of security markets knows the tendency during the period of rising values for the uninitiated to ascribe these rising values to pool activities and the like. The same tendency could be observed during 1932 when the market was falling, on the part even of those who had superior sources of information, to ascribe the decline to concentrated short-selling and similar activities. Undoubtedly a more active market, that indicates greater public participation in exchange transactions, increases the temptation to manipulate prices. But with practices of this character, by whomever employed, there can obviously be no tolerance either by the Commission or the exchanges. The instability created by undue speculation in our security markets cannot be permitted to be exaggerated by the intrusion of manipulation.

The distinction between manipulation and legitimate practices is not always easy to discern. Two series of transactions may superficially be the same and, yet one will fall within the ban of the law because of the purpose for which it is done, and the other will not. I give you this generality to illustrate one of the inherent difficulties involved in the detection of manipulation. Moreover, enforcement, to be effective, cannot be merely sporadic, nor can it be superficial. One can never know at what point in a series of apparently innocuous transactions the evil-doing will reveal itself. Enforcement must, therefore, have under continuous view the entire scope of trading in our security markets. It must follow to completion the examination of every suspicious circumstance. In a recent investigation the trail of stock transactions led through 197 brokerage offices. It took four months to complete. This was but one of many normal routine investigations which are at all times in progress. Today, as on every other day, there are between 50 and 75 specific stock market situations under inquiry. This picture may serve to convey to you some sense of what enforcement in this field implies.

The detection of manipulation is only one means of dealing with the broad problem of fraud prevention. The Commission this year put into operation a scheme for the registration of dealers and brokers in the over-the-counter markets. Such a scheme was essential to secure adequate data with reference to the persons who were making markets in this class of securities. Incidental to the broad plan of registration some minimum rules were adopted to provide a few simple standards that would tend toward the elimination of fraud and other unfair practices. Also, some dealers and brokers were denied the right to do business in this field because of misrepresentation as to their activities or proved unfitness to continue in that trade. This plan of registration has the important benefit of providing us with information as to the organization and past history of some 6,000 firms, corporations and persons engaged in the security business. It enables us, for example, to discover that men driven from the securities business in New York have fled to Michigan or from Michigan to Colorado. Freely interchanging our data with that of various state security commissions, we can thus make tight the network of fraud control over the United States as a whole.

I cannot pass by the creation and completion of these devices without expressing my appreciation of the spirit of cooperation and helpfulness that the Commission has met all along the line. As soon as the objectives of the Commission in this work became apparent, the fact that those aims were identical with the aims of the best element in the business and would redound to the benefit of that element, made assistance and helpfulness the keynote of the reaction of the security business to this work. For my part, and in behalf of the wider public good, I profoundly hope that that unanimity of purpose and activity will endure.

To sum up in broad terms the work of the Commission and make no mention of the Public Utility Holding Company Act, would be to forget an important portion of the Commission's activity and a significant function that has been entrusted to it since I talked to you two years ago. Here, again we are dealing with an act that aroused bitter antagonism from its inception. Unfortunately, however, the passage of this Act was not followed, as in the Exchange Act, by a similar willingness to work out its implications and to define in more concrete terms its objectives. From the beginning the Commission has been immersed in litigation with reference to the Holding Company Act and, until that issue of federal authority is settled, and definitely settled, the work of the administration is necessarily somewhat curtailed. Unfortunately, only a few of the larger holding companies pursued, what seemed to me then and what seems to me still, the wiser policy of working along under the Act and resorting to the courts when its administration would, in their judgment, do them concrete and unjustifiable hurt. The majority chose to resort, in the first instance, to the courts and, in thereby doing so, unfortunately transferred the heat of political controversy to the courts. That issue of federal authority must now be fought out with all the attendant waste that is involved in judicial struggles of this character when they take the form of a wholesale attack.

This issue, however, awaits decision and will, in all probability, come before the Supreme Court for adjudication at the next term of court. Meanwhile, our efforts are bent towards the creation of an administrative scheme that will be adequate for the task when the work of regulation will in all its fullness be upon us. In this, fortunately, we have had both help and guidance from the parties now affected. Its efficacy is being tested even now on a smaller scale by its application to the companies that are within our jurisdiction. I have heard nothing to indicate that they have suffered as a consequence either as to the efficiency of their operation or as to the security of their investments. Indeed, I believe that those companies who have had the wisdom to work with, rather than against us, will find that that judgment will result, not only in benefit to operation, but in increase of public esteem.

I have attempted to give you this broad picture of the Commission's activities under all three of the statutes administered by it. I hope I have given you some sense of the fact that the method of administration must approximate closely to the scientific process -- the attitude of accumulating adequate data for judgment before action. It seems to me an essential of proper administration that it must be able to gauge, rather than to guess, the consequences of its action. Especially true is this in a field such as finance, where governmental control is, as yet, with little concrete experience and with a far from trained personnel. Not only is this attitude of deliberation and study preceding action one which seems to me a necessity but one in which I, for one, take intense pride. Those who have only the slightest knowledge of our history in the development of administrative methods of control must recognize the unwisdom of hazarding all upon a prejudice. In dealing with the intricate mechanisms of finance, we are affecting forces far too vital to our national life to risk the possibility of ultimate failure. True, there have been and there will be errors but a ready and speedy recognition of misdirection is, in itself, the safeguard against the making of fundamental errors that cannot be repaired. If these attitudes and this spirit endure, and there is also firmness of purpose to accomplish the objectives of the legislation, one need have little fear of precipitate and ill-considered action on the one hand or of debilitating inaction on the other. Instead, from them should spring the hope that however unspectacular the task, the foundations for promoting our financial well-being are being laid well and enduringly.